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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, OCTOBER 29, 1984 VOLUME XXI, NUMBER 38

Profits: Now You Don't See Them . . .

The pronounced moderation in the pace of business activity in the third quarter will, no doubt, be reflected in third-quarter corporate profits. The earlier surge in business earnings had been a hallmark of the current business expansion. Pretax profits rose almost 60 percent in the first six quarters of this recovery, outrunning by far the average gain of less than 40 percent registered in the other postwar recoveries over the same period. This profit surge is even more outstanding, given the low rates of inflation accompanying the current expansion. However, the Commerce Department report that inflation-adjusted gross national product increased at a lackluster seasonally adjusted annual rate of 2.7 percent in the July-September period—far slower than the 8½ percent annual rate of rise posted in the first half of this year—brought concerns that the strongest gains in corporate profits might be over.

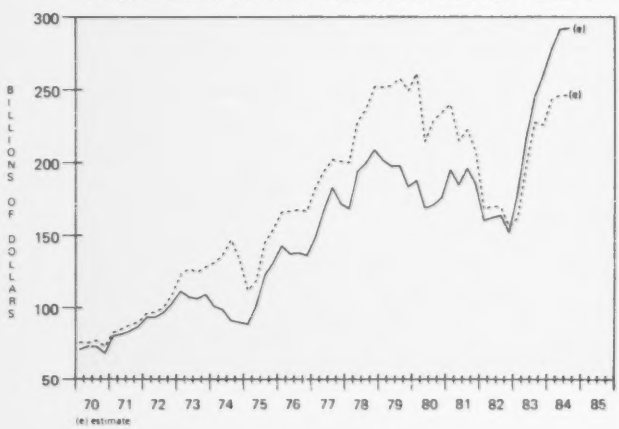
Although disappointing, this tapering in the growth of corporate profits is not unusual for this stage of the business cycle. As an economic expansion matures, companies approach fuller capacity utilization rates, putting upward pressure on costs. In fact, in the typical postwar recovery, pretax profits began to decline by the fifth quarter of the upturn.

What is more, in today's circumstances, the top-line profit figures do not adequately measure corporate earnings performance. For one thing, the change in the tax laws contained in the Economic Recovery Tax Act of 1981 permits companies tc depreciate capital equipment much more rapidly than in the past. At the same time, the low rates of inflation during the past three years have slowed substantially the increases in the replacement cost of plant and equipment. As a result, reported depreciation expenses overstated replacement costs in 1982 for the first time in almost a decade, and by the third quarter of 1984, depreciation allowances overstated current replacement costs by almost $59 billion. Since depreciation set aside to replace plant and equipment is subtracted from corporate revenues, its overstated value has depressed pretax book profits.

. . . Now You Do . . .

Moreover, the quality of book profits has been enhanced due to the moderation of inflation. During periods of rapid price increases, book profits are overstated because many companies subtract from their revenues the value of inventories used in production based on their original cost. In other words, the amount subtracted from earnings is understated because inflation has increased the cost at which used inventories must be replaced. In 1980, for example, when producer prices surged ahead by more than 13 percent, inventory profits alone accounted for almost 20 percent of pretax book profits. Lower inflation in the last few years has diminished accounting distortions, reducing such "illusory" inventory profits. By the second quarter of 1984, inventory profits represented only three percent of pretax profits.

PRETAX OPERATING PROFITS (LINE) VS. BOOK PROFITS (DOT)



The performance of corporate America looks brighter if measured by the operating profits. These are believed to be a more reliable gauge of profitability than book profits. This is because they exclude phantom inventory profits and are not distorted by either excessive or insufficient depreciation charges. As a result, in the last few years, the value of operating profits has exceeded book profits. While book profits today are still almost six percent below their peak reached in 1980, operating profits are now at an all-time high (see chart).

. . . But For Some Industries . . .

While the improved quality of earnings may provide some solace to company treasurers, it is book profits

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270 Park Avenue, New York, N.Y. 10017

which receive the most attention. Here, the third quarter's results are mixed. Take for exampie, the nation's retailers. Non-auto retail sales were less than one percent higher at the end of the third quarter than they were three months earlier. What is more, consumer resistance prevented merchants from raising prices the way they usually do during the back-to-school season. In fact, many were forced to conduct early promotions, to increase traffic in their stores thus cutting into profit margins. This is reflected in the Consumer Price Index for commodities excluding food and energy, which rose only 4.1 percent in the third quarter compared with the same period a year ago—the lowest year-over-year advance for any quarter in more than ten years.

After being in the black for only one or two quarters, the U.S. steelmakers had a very disappointing third quarter. To be sure, the slack in orders and shipments is partially attributed to the anticipation of a strike by the United Auto Workers. Uncertainties regarding the negotiations caused businessmen in related industries to cut back on orders, not wishing to get caught with high inventories.

. . . Earnings Growth Did Slow

With new orders already tumbling in first-quarter, 1984, domestic steelmakers were forced to reduce production sharply, causing capacity utilization to

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/24/84	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	156.645	– .670	– 1.413
Loans to Depository Inst.	5.645	– 1.177	+ 5.080
Float	.666	– .773	– .531
Total Reserve Bank Credit	175.155	– 2.717	+ 6.115
Treasury Deposits with Federal Reserve Banks	3.136	– .566	– 2.693
Currency in Circulation	176.392	– .857	+12.043
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	119.058	+ 3.951	+ 6.173
	10/24/84		
Member Bank Reserves:			
Total Reserves Held	37.779	– .303	+ 1.904
Excess (Deficiency)	.450	– .484	– .004
Net Free Reserves	.077	– .412	+ .042

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (10/15/84)	547.4	+ 0.7‡	+ 5.1‡
M2 (September '84)	2,305.3	+ 5.9	+ 7.3
M3 (September '84)	2,885.8	+ 7.0	+ 9.4
Domestic Nonfinancial Debt (2nd Q'84)	5,589.6	+ 12.9	+ 12.4

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 10/26/84	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	9.25%	9.50%	9.60%
* Federal Agencies	9.60	10.00	10.45
* Project Notes—Taxfree (46% Taxable Equivalent)	10.19	10.09	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	9.65	10.00	10.50

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	9.20%	Nov.	9.60%
15- 29 days	9.20	Dec.	9.65
30- 59 days	9.25	Jan.	9.80
60- 89 days	9.25	Feb.	9.85
90-179 days	9.08	Mar.	9.90
180-239 days	9.00	Apr.	9.90
240-270 days	9.00		

‡Industrial Paper—Prime			
30- 89 days	9.25%	†Federal Funds	
90-120 days	9.08	Effective Rate	9.55%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'84	$ 3,701	$ 3,645	$ 3,347
Gross National Product (1972 Dollars)*	3rd Q'84	$ 1,650	$ 1,639	$ 1,550
Percent Change, Annual Rate	3rd Q'84	2.7	7.1	6.8
Change in Consumer Prices (new series)*	Sep '84n	4.8%	6.0%	4.8%
Change in Producer Prices*	Sep '64	– 2.4%	– 1.2%	1.2%
Civilian Employment (Thousands of Persons)†	Sep '84	105,239	104,969	101,876
Unemployment as % of Civilian Labor Force†	Sep '84	7.4%	7.5%	9.2%
Personal Income*	Sep '84	$ 3,071	$ 3,045	$ 2,785
Leading Indicators Composite Index (1967=100)†	Aug '84	164.5	163.7	158.9
Industrial Production Index (1967=100) †	Sep '84	165.1	166.1	153.8
Net Change in Consumer Installment Credit †	Aug '84	$ 6.00	$ 7.11	$ 4.09
U.S. Merchandise Trade Balance †	Aug '84	–$ 9.86	–$ 14.06	–$ 7.16
Plant and Equipment Expenditures*	4th Q'84	$318.33(a)	$316.22(a)	$283.96
Private Housing Starts (Thousands of Units)*	Sep '84	1,676	1,539	1,679
New Construction Expenditures*	Aug '84	$ 311.7	$ 311.2	$ 278.0
Total Business Inventories †	Aug '84	$ 556.0	$ 551.4	$ 504.3
Total Business Sales †	Aug '84	$ 410.7	$ 411.4	$ 373.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. e-Anticipated.

plummet below year-ago levels. It was 53 percent by the end of the third quarter, compared with 82 percent four months earlier. Average monthly shipments of steel products fell 12 percent to below six million tons per month in July and August from the second quarter's 6.7 million ton average. With only two exceptions—oil and gas, and aircraft—every industry which utilizes steel cut its orders. According to the industry, this was more than the usual summer dip. And as shipments fell, so did employment: During August, domestic steel industry payrolls fell to 236,000—their lowest level in a year and a half.

The surge in automobile manufacturers' profits was halted in the third quarter. Profits were dampened not only by the usual stepped-up summer expenditures on retooling for model changeovers, but also by slower new car sales, which slipped below eight million units at a seasonally adjusted annual rate for the first time since the fourth quarter of 1983. However, this decline was probably caused by shortages of popular models, rather than a decline in consumer demand. Finally, several labor disputes cut into profits. The United Auto Workers struck against the largest U.S. manufacturer while the Metal Workers' strike in Germany affected the German operations of two of the Big Three producers. M

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (10/10/84)	159,420	+ 240	+16,113
New York City (10/17/84)	34,417	+ 98	+ 3,440
Commercial Paper (10/17/84)	233,304	+ 2,668	+55,110

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/10/84)	246,476	+ 186	+28,710
New York City (10/17/84)	64,115	– 982	+ 6,264

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/10/84)	630,130	+ 2,806	+93,882
New York City (10/17/84)	139,847	– 2,731	+20,004

Financial Markets

	Friday 10/26/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	9.59%	– .44	+ .64
180-Day Bills†	10.03	– .67	+ .50
Longest Bills†	10.41	– .59	+ .63
Recent Issues:			
11⅝s 10/31/86 (When Issued)	11.23	– .25	
11⅜s 9/30/88	11.61	NA	
12⅝s 8/15/94	11.90	– .35	
12½s 8/15/14	11.72	– .10	
Municipals:			
Bond Buyer–20 Bond Index* (10/25/84)	10.05%	– .19	+ .24
Blue List Total ($ Million)	$1,543	–$ 36	+ $ 81
30-Day Visible Supply ($ Million)	$2,520	–$1,612	+ $ 40
Total	$4,063	–$1,648	+ $121
Corporates:			
Moody's Aa Composite (10/25/84)	12.93%	– .22	+ .38
30-Day Visible Supply ($ Million)	$1,280	+$ 890	– $470
Stocks:			
Dow-Jones Averages:			
Industrials	1,204.95	– 20.98	– 18.53
Transportation	522.98	– 19.76	– 53.63
Utilities	141.57	– 3.23	+ 2.31
65 Stocks	476.12	– 11.22	– 16.83
Standard and Poor's 500 Stocks	165.29	+ 2.61	+ 1.92
N.Y.S.E. Composite Index	95.34	– 1.52	+ 1.06
N.Y.S.E. Avg. Daily Vol. for Week (000's)	88,386	–33,578	+ 6,610

* 46% Taxable equivalent 18.61%.

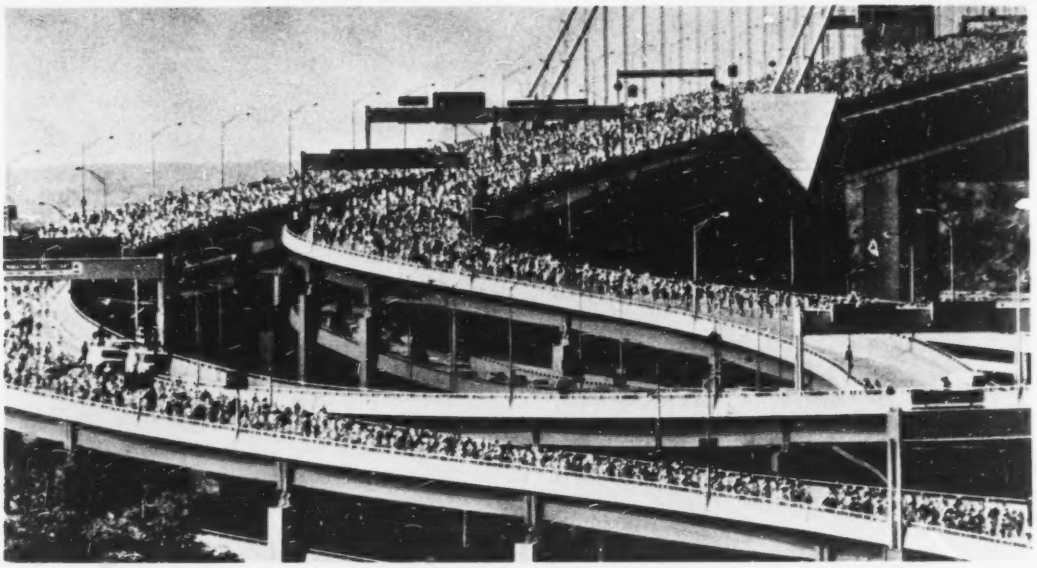
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/26/84	Week Ago
Overnight	9.50%	9.63%
1 month	9.69	10.00
3 month	10.13	10.31
6 month	10.56	10.56
1 year	11.00	11.13
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	12.20%	12.25%
Long Term (7 to 15 yrs.)	12.30	12.35

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/26/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01634	61.19
Canada	.7602	1.3155
Denmark	.09132	10.9500
France	.1076	9.2950
Germany	.3300	3.0300
Italy	.0005313	1882.00
Japan	.004076	245.35
Mexico	.004843	206.50
Netherlands	.2926	3.4175
Switzerland	.4017	2.4895
U.K.	1.2208	.8191



The New York City Marathon,™co-sponsored by Manufacturers Hanover

The marketplace demands sustained effort.

Manufacturers Hanover strives.

Winning a 26.2 mile marathon takes planning, positioning, and endurance. And in much the same way, Manufacturers Hanover's planning, positioning, and willingness to accept challenges are paying off significantly.

For example, our subsidiaries now have more offices nationwide than any other bank holding company, giving us instant access to both large and middle market companies. This enables us to provide other financial services besides banking—factoring, equipment financing, and mortgage lending.

But the race is far from over. As the need arises for new kinds of financial relationships, Manufacturers Hanover will be prepared to supply whatever the national—and international—marketplace demands. Consider the source.

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WASHINGTON, DC 20014